

**DEPARTMENT OF STATE REVENUE**

**LETTER OF FINDINGS NUMBER: 96-0636 GIT**

**Gross Income Tax**

**For Tax Years: 1987-1995**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department=s official position concerning a specific issue.

**ISSUES**

**I. Gross Income Tax C Municipal water utilities**

**Authority:** IC 6-2.1-2-2; IC 6-2.1-1-16 (23); IC 6-2.1-1-16(25); Department of Treasury v. City of Linton, 60 N.E.2d 948, 949 (1945)

Taxpayer protests the imposition of gross income tax on its municipally owned water utility.

**II. Tax Administration B Imposition of Negligence Penalty**

**Authority:** I.C. 6-8.1-10-2.1; 45 IAC 15-11-2

Taxpayer protests the imposition of the ten percent (10%) negligence penalty.

**STATEMENT OF FACTS**

The taxpayer is a city that operates a water and sewage utility for its citizens. The municipal utility failed to file a file an IT-20G return reporting its receipts from a water utility operation.

**I. Gross Income Tax C Municipal water utilities**

**DISCUSSION**

The taxpayer protests the imposition of gross income tax on its receipts for a water utility operation from 1987-1994. The taxpayer did not file taxes for these years. The taxpayer contends that since it is a governmental entity it is exempt from the gross income tax.

The gross income tax is imposed "upon the receipt of the entire taxable gross income of a taxpayer who is a resident or domiciliary taxpayer of Indiana..." (IC 6-2.1-2-2). For purposes of the gross income tax, "taxpayer" includes most corporations (IC 6-2.1-1-16(23)). The term "taxpayer" also includes any "political subdivision of the state of Indiana, to the extent engaged in private or proprietary activities or business" (IC 6-2.1-1-16(25)). Provided that any exemption does not apply, the taxpayer, a municipal corporation, is subject to the gross income tax.

A municipal corporation that performs governmental services and receives gross income therefrom is exempt from the gross income tax (IC 6-2.1-3-29). IC 6-2.1-3-29 provides the following:

Gross income received after December 31, 1964, that is derived from the operation of a park or recreation facility, the sale or lease of real property, the occasional sale or lease of personal property, or the performance of similar governmental services is exempt from gross income tax if the gross income is received by the state of Indiana, an agency or instrumentality of the state of Indiana, or a municipal corporation or political subdivision of the state of Indiana.

In light of the aforementioned governmental services exemption, the issue before the Department is whether the taxpayer is operating in a proprietary capacity or a governmental capacity. We need to look no further than the on point case of Department of Treasury v. City of Linton, 60 N.E.2d 948, 949 (1945), in which the Indiana Supreme Court held that the operation of private utilities by a municipality for service to its inhabitants has long been held in Indiana to be a proprietary and not a governmental activity. The court held that "when a municipal corporation engages in an activity of a business nature rather than one of a governmental nature, such as the supply of light or water or the operation of a railroad, which is generally used by individuals or private corporations, it acts as such corporation and not in its sovereign capacity...a city operates its municipally owned utility plant in its proprietary capacity as a private enterprise subject to the same liabilities, limitations and regulations as any other public utility..." Id. at 950.

Using the case of Linton as guidance, the Department finds that the taxpayer is conducting "private or proprietary activities or business" under (IC 6-2.1-1-16(25)) and consequentially does not qualify for the governmental services exemption from gross income tax.

### **FINDING**

The taxpayer's protest is denied. The taxpayer owes for the gross income tax for all of the audit period.

## **II. Tax Administration - Imposition of Negligence Penalty**

### **DISCUSSION**

Taxpayer protests the imposition of the ten percent (10%) negligence penalty. The negligence penalty imposed under I.C. 6-8.1-10-2.1 may be waived by the Department where reasonable cause for the deficiency has been shown by the taxpayer. Specifically:

The department shall waive the negligence penalty imposed under I.C. 6-8.1-10-2 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. 45 IAC 15-11-2(e).

The taxpayer is a municipality and had a reasonable belief that it was acting as a governmental capacity and therefore exempt from the gross income tax.

### **FINDING**

The taxpayer's protest is sustained. The ten percent (10%) negligence penalty will be waived.